Corporate Resources Department

[redacted]

THE CITY OF CALGARY

CALGARY ECONOMIC OUTLOOK

1991 THROUGH 1995

R.A.D. Beck, PhD
Corporate Economics Division
Corporate Resources Department

October 15, 1990

91-02847/

TABLE OF CONTENTS

FOREWORD 1

Energy 2

The American Economy 4

The Canadian Economy 5

Province of Alberta 7

The City of Calgary 9

Construction Activity in The City of Calgary: 1991 to 1995 10

Office Space 10
Hotels 10
Warehouse Activity 10
Apartments 11
Shopping Centres 11
Residential 12
a. Townhouses 12
b. Single Family Houses Permits 12

Summary 13

FOREWORD

The invasion of Kuwait by Iraq has resulted in an embargo on energy supplies from both Iraq and occupied Kuwait. While tensions in the middle east are apparent, world shortages of oil are not. However, rumours and speculations continue to fuel high oil prices on the international markets.

While high oil prices increase the optimism amongst energy companies, few companies, if any, believe that prices above $30 (US) per barrel would prevail in the longer term. Besides placing the long term stability of OPEC production itself at risk, and short of war, numerous economic considerations begin to interact with the possibility of "higher-than-anticipated" oil prices.

Higher prices discourage consumption and economic growth in most nations, encourage domestic conventional oil exploration, encourage the more rapid development of synthetic and heavy oils developments and promote alternative fuels developments. All of these factors are detrimental to OPEC's long run pricing stability and production.

Until an element of longer term normalacy returns to international energy prices, little in the way of new energy investments will be announced. While domestic oil producers realize substantial short term increases in cash flow, this factor alone will not result in immediate investments and increased expenditures. More possibly, increased revenues will be used to reduce debt and/or increase the cash reserves of energy companies.

The essential elements of this outlook are predicated upon:

- A peaceful settlement to the Middle East crisis with a return to stable oil prices in 1991 in the range of $22 to $23 per barrel (US) relative to an anticipated pre-crisis $20 price. Oil prices then increase at approximately 4.5% (average inflation) per year over the forecast period.

- Canadian interest rates continue to decline modestly in the last half of 1990, with the commercial bank rate falling to approximately 12.5% in the Spring of 1991.

- After the GST inflationary "shocks" in the first quarter of 1991 have been absorbed, bank prime interest rates decline another 150 points (to approximately 11.0% through the remaining months of 1991. A 10.0% to 11.0% interest rate range is anticipated over the remaining portion of the forecast period.

- The decline in interest rates is accompanied by depreciation of the Canadian dollar to the $.84 (US) to $.83 (US) range.

- The Canadian economy remains in its "slow growth" position throughout 1990 and much of 1991. Thereafter, the national economy begins to recover from the current recession and impacts of higher oil prices.

- National inflation levels decline over the next few months (to around 4%) and the unemployment rate exceeds 8.5% for the balance of 1990.

- National unemployment levels remain in the 8 to 9% range over the period 1991 through 1995.

- The impact of the "one-time" price adjustment for GST in 1991 will be at least 1.5%, as many firms attempt to increase operating margins at the expense of the federal government. National inflation levels increase to 6.5% for 1991.

- Ontario and Quebec will bear the brunt of the recession in 1990 and 1991.

- Positive GST impacts in January 1991 with a zero rating on manufacturing exports, together with exchange rate declines and positive incentives from the Free Trade Agreement reinforce export increases of manufacturing goods in late 1991 and throughout the remainder of the forecast period.

- The province of Alberta will experience real economic growth, above the national average over the entire forecast period.

Energy

In the short run, higher oil prices in the mid $30 (US) per barrel range will result in 1990 oil prices averaging approximately $24 (US) per barrel. While a Middle East conflict is possible, a stronger possibility is a peaceful solution to the crisis, with oil prices adjusting to a $22 level in the latter part of 1991, together with some semblance of both price and production stability.

At a slightly higher than anticipated oil price the economies of most nations will have to adjust for both the current oil price shock and for a continued oil price above that previously expected.

While short run increases in cash flows will accrue to both oil companies and governments in energy producing sectors, little change in investment activity by energy companies is anticipated until it becomes clearer that stable prices above $20 will continue to prevail. Both government and energy companies, on the receiving end, are expected to reduce debts in the short run.

While most energy companies will be re-examining new conventional, synthetic and heavy oil projects as well as alternative fuel developments, few new investments are anticipated in 1991. However, given a stable oil price regime above $20 and no significant changes in the tax and royalty structure, numerous energy investments will occur in the post-1991 period.

Surpluses of natural gas have tended to keep prices in the lower end of the spectrum, however, security of American energy supplies and diversification into alternate fuels will increase the demands for Canadian natural gas. Increased investments in both natural gas facilities and transmission projects will continue over the forecast period. Natural gas prices are expected to increase significantly in 1991 and beyond, as demands for alternative supplies and environmentally clean fuels increase.

Oil Price Outlook: 1990 to 1995

	1990	1991	1992	1993	1994	1995
	(yearly average)					
WTI (US $/barrel)	24.0	22.5	23.5	25.5	26.7	27.9

The American Economy

The U.S. economy continues its current slowdown throughout 1990 and much of 1991, with both prices and unemployment increasing as higher energy prices impact the economy. The economy strengthens in late 1991 and grows at a real rate of 2% to 3% through 1995. Inflation moderates to approximately 4% and the labour force continues near "full employment" with unemployment levels of 5% over the forecast period.

The price paid for oil imports influences heating, transportation and manufacturing cost structures throughout the economy. Therefore, high energy costs translate into higher operational costs, reduced demands and lower growth. Since 60% of U.S. oil supplies are imported, high oil prices result in a worsening U.S. trade balance.

Largely as a consequence of the current energy crisis, the US is expected to strengthen its North American energy ties over the forecast period and place considerable emphasis on the development of alternate fuels, particularly methanol and compressed natural gas. The California alternative fuels program, beginning in 1994, is increasing evidence of the move towards natural gas as an environmentally clean alternative fuel.

A shift in emphasis from monetary policy to a tighter fiscal policy is anticipated and both long and short term interest rates are forecast to decline gradually over the period. Some progress is expected in deficit reduction in the United States, largely through defense savings (such as troop reductions). The decline in real interest rates results in an exchange rate depreciation which strengthens the potential for increases in US exports. The impact of "Europe, 1992" creates a stronger impetus for growth in Europe which also creates demands for American products and materials.

The U.S. Economy: 1990 to 1995

	1990	1991	1992	1993	1994	1995
Real GNP (%)	1.2	1.0	2.9	2.6	2.5	2.3
Inflation (%)	5.2	5.0	4.2	4.0	4.0	4.0
Commercial Paper Rate	8.0	7.4	7.2	6.8	6.5	6.5
Unemployment (%)	5.4	6.5	6.0	5.5	5.2	5.2

The Canadian Economy

The national economy continues to maintain a precarious position on the economic high wire. Many Canadians, particularly those in Central Canada, have felt the impacts of a recession for much of 1990. The slowdown in the national economy is expected to continue throughout 1990 and well into 1991.

The substantial declines in Canada's national production are largely attributable to policies of the Federal government. A federal quest to quell inflation has played a significant role in reducing real growth in the Canadian economy from 3% in 1989 to 1.5% for 1990.

High interest rates have reduced consumer and investment demands while national inflation rates continue to hover around 5% and labour costs continue to increase. National unemployment levels have increased from an average of 7.5% in 1989 to over 8.0% in 1990.

While the general economy has lost momentum, the recessionary impacts are both regionalized and industry specific. While most provincial economies have weakened, both Alberta and British Columbia have remained reasonably strong. With diminished construction demands in the U.S. envisaged for 1990 and 1991, the lumber industry in British Columbia is expected to weaken.

Diminished demands have particularly impacted the manufacturing and construction sectors in central Canada. The level of unemployment in the manufacturing sector has increased substantially and is forecast to remain high over the next five year period.

Despite the potential advantages obtainable from the Free Trade Agreement, Canadian exporters have faced rising domestic costs, high interest rates and high foreign exchange rates. Continuing demands for increased imports by the United States have helped to maintain a reasonable Canadian trade balance and a high foreign exchange rate.

The implementation of the Goods and Services Tax (GST) in January 1991, coupled with removal of the present Manufacturer's Sales Tax (MST), will provide price reduction incentives to Canadian manufactures engaging in exports. However, the domestic effects of the GST will result in at least a 1.5% increase in the inflation rate as the impacts of the tax are spread throughout the economy. These price increases will tend to reduce consumer spending in the economy in 1991.

Future energy prices will also play a strong role in the timing of Canada's economic recovery. The strength of the American economy will largely determine whether Canada's manufacturing sectors increase their export activity in 1991 even with incentives attributable to both the GST and the Free Trade Agreement.

Domestically, higher energy prices benefit energy producing regions but result in higher costs, reduced growth and fewer employment opportunities for the non-producing areas. The impact of $22 to $23 dollar per barrel oil prices in 1991 will reduce economic growth in central Canada and have a further inflationary effect on the economy in 1991.

In the energy producing areas, higher prices in 1991 will encourage investments in conventional drilling, synthetic and heavy oil developments and alternate fuels developments.

The large interest rate "gap" continues to exist between American and Canadian interest rates. Whether the Federal government moves to reduce domestic interest rates depends upon what economic trade-offs are acceptable to the government, their determination to reduce the national deficit, and the performance of the US economy. Narrowing of the spread between US and Canadian interest rates is anticipated over the forecast period.

Besides new pressures for energy investments in Canada in the post-1991 period, there will be international demands for investment towards economic reconstruction in Eastern Europe, to continue the pace of development in Southeast Asia and to promote developments in Latin America.

The National Economy: 1990 to 1995

	1990	1991	1992	1993	1994	1995
Real GDP (%)	1.5	1.4	2.5	3.4	3.0	2.8
Inflation (%)	5.2	6.5	5.5	4.7	4.5	4.0
Unemployment (%)	8.1	8.7	8.6	8.4	8.2	8.1
Prime Commercial Rate	13.0	11.0	10.5	10.5	10.0	9.5
Exchange rate (U.S./Can$)	86.0	84.0	83.0	83.0	83.0	83.0

Province of Alberta

Prior to Iraq's invasion of Kuwait, economic growth in the province of Alberta was expected to exceed the national level for only 1990 and 1991. Thereafter, the more positive effects of GST and free trade developments would induce slightly higher growth in Central Canada through the period 1992 through 1995.

However, the uncertainties associated with the Middle East crisis now make it more likely that Alberta's growth will be strongly influenced by increased energy investments in the post-1991 period, thereby helping to push the province's real growth above the national average for the entire forecast period.

Oil price stability, above $22 (US) is expected to encourage numerous investments in conventional exploration, drilling and production, synthetic energy development, heavy oil and alternative fuels projects in the province. While higher oil prices result in substantial increased royalty revenues to the province, these revenues, in the short run, will probably be used to either reduce the Provincial deficit and/or retire debt. In the post 1991 period increased royalties could be used to encourage Alberta energy projects.

While the border price of natural gas is currently depressed due to modest export demands and relative to Alberta supplies, the forecast is for natural gas prices to increase at rates much higher than conventional oil. The trend is to increased demands for natural gas as a heating, generating and transportation source. Both domestic and U.S. demands for supplies of Alberta's natural gas are expected to increase substantially, accompanied by a corresponding increase in the pipeline capacity to accommodate this increased flow.

In other resources sectors of the provincial economy:

- the capital construction impetus from forestry investments will be transformed in the post-1991 period to one of sectoral production,
- while farm incomes are weakened by low prices, grain output is expected to increase over the five year period.
- the demand for Alberta livestock is expected to strengthen and provincial output in this sector will also increase over the forecast period.

A continuous change in Federal government procurement policies encouraging western production and a continued emphasis on the promotion of Pacific Rim and American trade throughout the western provinces is expected over the next five years. As a consequence, Alberta will see above average demands placed upon manufacturing, transportation, trade and services sectors over the forecast period.

The Alberta Outlook: 1990 to 1995

	1990	1991	1992	1993	1994	1995
Provincial GDP (%)	2.4	3.0	3.2	3.4	3.2	3.5
Agriculture (%)	2.1	4.5	4.1	2.2	1.7	1.6
Oil & Gas (%)	1.8	4.3	4.4	3.8	4.0	3.5
Manufacturing (%)	5.9	3.5	4.2	5.4	4.6	4.2
Unemployment (%)	7.4	7.4	7.5	7.4	7.3	7.2

The City of Calgary

A number of positive factors make Calgary one of the few places to "be", both in the current recession and beyond. While most Canadian regions are facing longer unemployment lines and economic constraints, there are regional elements that tend to partially insulate the City from the recessionary bite and contribute to its economic growth.

- Labour force participation rates are traditionally high in Calgary. The City has a predominately "white collar" labour force with both individual and family incomes well above the national average. This income is derived from a multiplicity of sectors that, initially fired by resources, have now expanded to include strong financial, manufacturing, transportation, utilities and services sectors.

- The City is fortunate to have the corporate head offices of dozens of large firms representing these sectors. Well over 1/3 of all Calgary's employment is currently found in the services sector.

- Over the past decade, Calgary's exports have increasingly moved towards a North -South and Pacific Rim basis and away from the older Alberta - central Canada axis.

- Higher than average incomes have resulted in increased wholesaling, retailing and service activities. Increased incomes have also encouraged the pursuit of sports, leisure and recreational activities.

- The local economy is expected to continue its diversification through increased economic activity and stronger-than-average employment growth in manufacturing, communications, transportation, trade and services sector expansions. In the five year forecast period Calgary's net migration is expected to continue above 8500 migrants per year.

Construction Activity in The City of Calgary: 1991 to 1995

Office Space

The demands for office space moderated over the past 12 months due to the threat of recession, high interest rates and uncertainties facing the energy sector. However, increasing "optimism" is expected to affect office construction in the in the five year forecast period.

The possibility of higher-than-anticipated resource prices and reduced interest rates may well encourage earlier starts to the office towers planned over the next five years. In addition to approximately 900,000 square feet of double AA office space currently under construction the potential exists for at least two additional towers over the forecast period.

Hotels

Calgary's attractiveness as a destination, in terms of both tourist flows and conventions, is increasing. The prospects are reasonable that three new hotels will commence construction over the period 1991 to 1995.

Warehouse Activity

Absorptions of the large amounts of existing warehouse stock built around 1980 did not make an appreciable dent in warehouse vacancies for several years. In 1987, vacancies averaged 9.6%. Since 1987, vacancy declines have encouraged rent increases and higher economic returns. City-wide warehouse vacancy rates are currently less than 2.5%.

Despite higher interest rates, continued demands for quality warehouse space have contributed to a continuation of rising rents and warehouse building activity throughout both the northeast and southeast quadrants of the City.

Warehouse Permits: 1990 - 1995

	1990	1991	1992
	(thousands of square feet)		
Northeast	1,000	700	700
Southeast	780	800	960

Apartments

Substantial vacancies and low economic returns discouraged new apartment construction for much of the 1980's. Given the large number of apartments completed before 1982, Calgarians have enjoyed apartment choice with modest rents for the past 8 years. In 1983, apartment vacancies in the City exceeded 17%.

Continued population growth and changes in family formation gradually reduced apartment vacancies. Significant rental increases occurred in Calgary in 1989 as aggregate apartment vacancies fell to the 4% level. The CMHC survey of apartments of six or more units in 1989 indicated a vacancy rate of less than 2.5% in the Spring of 1989 and less than 1.2% by Fall, 1989.

Calgary's apartment market was heating up. As vacancies declined and rents increased, renewed interest in apartment construction emerged. Over the past nine months, some 2,000 apartment units have been submitted for planning approval as developers positioned themselves for a new wave of apartment construction in Calgary.

However, higher than anticipated interest rates and a short term move from apartments to housing have resulted in higher than anticipated vacancy rates (currently in the 2.5% range), creating a stronger degree of uncertainty in developer's plans. Given the prospects that both interest rates and apartment vacancies will decline in the near term, numerous apartment projects will commence over the five year forecast period.

Apartment Permits: 1990 - 1995

1990	1991	1992	1993	1994	1995
		(units)			
500	700	700	600	600	600

Shopping Centres

While much of the large shopping mall construction appears to have temporarily abated, smaller strip mall construction has continued throughout the City. While planning approval has been granted for development of regional shopping centres, construction is contingent upon community population increases in these areas.

Shopping Centre/Retail: 1990 - 1995

1990	1991	1992	1993	1994	1995
		(thousands of square feet)			
200	300	400	450	200	200

Residential

a. Townhouses

There are currently over 1300 townhouse units in the planning developmental stage in Calgary. While many of these units will not proceed until there has been some moderation in interest rates, the number of townhouses built in the City over the next five years is expected to increase.

Townhouse Permits: 1990 - 1995

1990	1991	1992	1993	1994	1995
		(units)			
800	800	700	700	700	800

b. Single Family Houses

As Calgary continues to adjust to the high interest rates and the six month splurge of housing activity in late 1989 and early 1990, fewer than 250 single family housing permits per month are expected for the remainder of 1900. Even with interest rates slowly declining, little change in new housing demands is foreseen over the balance of the year and into early 1991.

Consumer uncertainty with respect to the economy and to the future changes in the prices of all commodities as a consequence of the GST are expected to outweigh initial declines in interest rates. This uncertainty will not be alleviated until the Spring, 1991, when interest rates have experienced some decline and new housing prices and other inflationary impacts of GST are clarified.

Single Family Housing Permits: 1990 - 1995

1990	1991	1992	1993	1994	1995
		(units)			
4500	4400	4700	5000	5200	5400

While there have been reductions in labour requirements for the single family housing sector, construction activity in offices, warehouses, apartments, retail, townhouses and other areas is expected to place continuing demands on occupations in this sector.

Summary

A summary of Calgary's expected performance over the period 1991 through 1995 is given below:

The Calgary Economy: 1990 - 1995

	1990	1991	1992	1993	1994	1995
Demographic						
Net Migration * ('000)	11.8	8.5	9.0	9.5	10.5	11.0
Population * ('000)	693	710	728	746	765	784
Economic Indicators						
Calgary CPI (avg.%)	6.2	8.0 **	5.5	4.5	4.5	4.5
Unemployment (%)	7.0	7.6	7.3	7.0	7.0	6.5
New Housing Price Index	132.0	136.0	146.0	153.0	160.0	168.0
MLS index ***	114.0	123.0	136.0	147.0	158.00	169.0

* As of April
** Includes an 1991 GST implementation adjustment of 1.5%
*** Based on a June 1981 average MLS price of $110,00.

Balancing a national economy on a razor's edge is not an enviable undertaking. If the Federal government planned to wait until inflation was curbed before reducing interest rates, it must now include in its equations the negative impacts of higher energy prices on both the domestic and US economies.

While we anticipate declines of over 300 basis points in interest rates over the forecast period, there will not be an immediacy in this direction. Rather than a sharp decline, a gradual fall in interest rates through 1991 is expected. Until the impacts of GST are apparent, a full move in this direction is not envisaged. In the post 1991 period, interest rates in the 10 to 11% range are anticipated.

In both the short and medium term, the local economy appears better poised to weather the recessionary impacts than other areas of Canada.

RADB/jjm
90.10.19(1266/90)